



Independent Research

November 2006

## The Kiri Park Projects 2007 Growers

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Richard Cruickshank, Managing Director.

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## The Kiri Park Projects 2007 Growers

### Summary

#### Offer Overview

Environmental Forests Farms Management Ltd (EFFM), the Responsible Entity (RE), is offering investors the opportunity to subscribe for interests in the Kiri Park Projects 2007 Growers (the Project). These interests will allow investors to become growers of Paulownia in WA and share in any sale proceeds of timber produced by the Project. Growers will have the option to leverage into the Project via finance facilities provided by a company related to the RE.

#### Evaluation Summary

Evaluation of the investor options related to the Project show that the Project is capable of attaining a high level IRR, based on the assumptions utilised by the RE and PIR in the modelling process. Leveraging of the investment via the finance facility also provides a potentially higher return, although with attendant risk. The Project is not expected to pay investors a distribution until after the first harvest and sale of timber, anticipated to be in year seven, with successive harvests in years eight, nine and ten. The purchase of a WA based timber milling company by the parent entity of the RE should allow additional benefits from vertical integration to the Project.

#### Management

EFFM was licensed as an RE in 2004, with the parent entity, Environmental Forest Farms (E.F.F. Limited), established in 1997. EFFM was established in 1999 and has been establishing and managing Paulownia plantations since that time. The EFF Group has established four prior projects revolving around the production and management of Paulownia plantations in WA. As at 30 June 2006, the RE had in excess of \$10.9 million in funds under management.

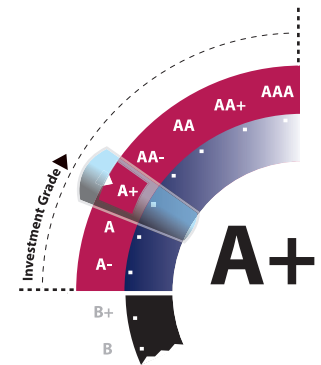
### Major Considerations

- ▲ Potentially high returns, particularly on a geared basis.
- ▲ EFFM is a recognised operator in this market niche in Australia and has made significant inroads into sustainable development of Paulownia plantations and is continuing to vertically integrate its operations.
- ◀ While the RE has a signed contract with a buyer, which expires in 2012, to purchase some of the processed timber from previous projects, the bulk of timber produced under this Project is not covered by a sales contract.
- ◀ Paulownia, as a commercial crop, is yet to be fully established in Australia, with commercial harvesting and outcomes yet to be fully assessed. However, EFFM has a track record of establishment and management of plantations and is well placed to be a competitive industry operator.
- ◀ Agribusiness operations rely heavily on the capacity of management, thus any changes to management can have a substantial impact (positive or negative) on ultimate investment performance.
- ▼ Prices paid to growers are difficult to establish, due to the lack of existing established markets.
- ▼ Project costs on a per hectare basis are significantly higher than comparable industries would suggest.

<sup>1</sup> This report, dated 29 November 2006, expires when the initial offer closes or after 6 months or if there are any material changes in relation to the information contained in this report or any disclosure or offer document issued in relation to this offer. This report was not prepared for inclusion in any offer document and investors must only rely on information contained in the offer document and other associated information. PIR reserves the right to change its opinion, ratings and/or withdraw the report at any time on reasonable grounds.

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#### Overall Investment Rating



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Latest report expiry: 28 May 2007 <sup>1</sup>

#### Scheme Details

The Kiri Park Projects 2007 Growers	
ARSN 107 747 348.	PDS dated 6 November 2006
Project type	Agribusiness
Duration of investment	10 years
Liquidity	Nil
Finance available	Yes
Product Rulings	PR 2006/150 & PR 2006/151
Adviser Commissions	10%

#### Responsible Entity (Manager)

Environmental Forest Farms Management Ltd  
(ACN 087 201 670)

#### Custodian

Environmental Forest Farms Management Ltd  
(ACN 087 201 670)

#### Investment Profile

Project location(s)	WA
Minimum subscription	One allotment
Project allotment	0.108 Ha
Minimum initial investment (inc GST)	\$6,390

#### PIR Returns Outcome (Internal Rate of Return)

46.5% tax rate	11.95%
31.5% tax rate	11.95%
15% tax rate	11.95%

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## Conclusion

Qualitative Criteria	Star Ratings Assessment (0 – 5)				
Returns in excess of Bond Rate	★	★	★	★	
Quality of asset	★	★	★		
Strength of relative commodity market	★	★	★		
Diversification	★				
Quality of income stream	★	★	★		
Potential upside for project	★	★	★		
Marketing & Sales	★	★	★		
Level of fees	★	★			
Agronomic factors	★	★	★	★	
Quality of disclosure	★	★	★		
Track record and capacity of Management	★	★	★		

Table i

This Project will be part of an existing development operated by the RE at Regan's Ford in the Gin Gin region of WA. The RE has already established in excess of 170,000 Paulownia trees on approximately 300 hectares at this location and currently has additional requirements for plantable areas and infrastructure relating to irrigation to allow for planting of an additional 40,000 trees at the site (under current planting regimes). Investors will become growers of Paulownia fortuneii on 0.108 hectare Woodlots. The RE anticipates that harvesting of investors' Woodlots will commence in year seven, with two additional harvests in years eight and nine, before clearfelling in year 10. The Project is expected to produce Paulownia logs for processing into a range of products, which may include lightweight jointed board for architectural applications and panelling for marine applications. Finished boards may also be used for furniture, blinds and a range of applications, where high quality finish and light weight are important.

Despite Paulownia having a limited history of commercial production in Australia, the RE is placed to be one of the first groups to undertake commercial harvesting of Paulownia. To PIR's knowledge, the RE will be the second group to undertake commercial harvesting of Paulownia outside of trial plots and small holdings from private landholders. Final production data relating to achievable growth rates is, as such, currently unavailable,

however the RE will be in a position to more accurately determine growth rates for the species based on harvest trials being undertaken from its trial plantation, which was planted in 1996 at Nowergup, approximately 120 kilometres south of the project site.

PIR has sighted a timber sales agreement confirming that an amount of timber produced from previous projects (10,000m<sup>3</sup>) has been committed for purchase from Primary Securities Ltd, the previous RE of the Kiri Park Project No. 1 & No. 2. While this indicates that initial marketing efforts are having some positive results, PIR is unable to verify the ongoing reliability of this entity. Investors will be reliant on the ability of the RE to sufficiently develop markets over the term of the investment to produce viable product distribution channels for the timber produced by this Project.

Investors in the Project will pay an upfront application fee of \$6,390 (including GST), which may be financed through an associated company; Forestry Finance Limited. Investors will also be liable for annual fees relating to management costs and license fees until the final harvest. At the end of each harvest, investors will pay EFFM a harvest fee based on a price per cubic metre of log, and a 5.5% fee based on gross proceeds of sale. Product Rulings (PR 2006/150 and PR2006/151) confirm the deductibility of upfront fees subject to usual conditions.

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## Key Assessment Issues

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Given that Paulownia, as a commercial crop, is yet to reach maturity as an industry within Australia, key issues will involve the assumptions being made of the yields of saleable timber from the Project and the sale price and availability of markets for the timber. Few commercial harvests of Paulownia have yet been undertaken in Australia and while the RE and others have undertaken progressive sampling of trees in their plantations to provide indications of growth rates and yields, data will be limited until such time as large scale commercial harvesting and marketing come into play.

Marketing of the saleable timber by the RE will also be a critical factor. Paulownia being produced in Australia is generally being targeted as a substitute product in relation to marketing strategies being used by producers, although there is the possibility for new markets for value added processed timber products to be developed. The RE is now beginning to have sufficient experience in the development of Paulownia plantations and ongoing management so that the production of Paulownia now does not have the same level of uncertainty for producers as it did in earlier years of the industry. While test data may assuage commercial harvesting issues, the potential for market penetration and

pricing levels on a commercial basis still remains to be seen. Given the early stage of the industry's life cycle, Paulownia's ability to penetrate the market on a cost effective basis as a product substitute against more widely accepted timbers which are already in use, will be a key issue.

In June 2006, the EFF Group acquired Highpoint Timbers ("Highpoint"), a Western Australian timber wholesaler based in Rockingham. Highpoint is now the registered trading name of EFF Timber Pty Ltd, a wholly owned subsidiary of the EFF Group of Companies. Highpoint has been involved in importing, milling, processing and selling Paulownia timber to Australian and overseas markets for over 10 years and has experience in Paulownia's timber properties, milling and processing techniques. As part of the EFF Group of Companies, Highpoint will have access to timber produced by the EFF Group, as well as remaining a buyer and importer of Paulownia timber from China.

The presence of the RE's research plantation at Nowergup provides alignment with the aims and objectives of the management team in maximising efficiency in plantation management and producing saleable timber.

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## Project Structure & Strategy

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### Structure

Investors' interests in the Project will consist of Woodlots of 0.108 hectares with a stocking level of 60 trees.

Minimum investment in the Project is the subscription of one Woodlot. Investors will enter into a lease and management agreement with the RE; licensing the investor to utilise a Woodlot and committing the RE propagate the trees and manage the Woodlots for the term of the investment, as well as harvest, market and sell the timber.

Investors should be aware that the Project should be treated as long term and illiquid. There is no overall minimum subscription for the Project to commence.

### Finance

The RE has provided finance options to investors in the Project, through a wholly owned subsidiary of the RE; Forestry Finance Limited. Investors will be offered the option of three different facilities, all paid monthly:

- A 12 month interest free period, repayable in 12 equal instalments of the principal amount.
- A five year term loan with a minimum 10% deposit, followed by repayments of interest plus principal.

- An eight year term loan with a minimum 10% deposit, followed by repayments of interest plus principal.

Interest on the loan will be levied at 12.5% p.a. fixed for the term of the loan and will be subject to an establishment fee of \$300. Investor loans are full recourse and secured by a charge over investors' Woodlots. Investors may borrow up to 90% of the application amount.

### Strategy

This Project allows investors the opportunity to become growers of Paulownia in a managed plantation. The RE is to provide the necessary staff and infrastructure required to establish, grow, harvest and arrange the sale of a grower's timber. Investors in the Project will be classed as growers of the timber via a forestry right over the trees grown for them by the RE. Investors pay fees to the RE for the establishment of the Woodlots and can expect to receive returns from the harvesting and sale of the sawn timber after harvesting, milling and marketing fees have been deducted from harvest proceeds.

Post establishment, investors' trees will be progressively harvested in years seven, eight and nine through to year



10, where the Woodlots will be clear felled. The RE's marketing strategy is not highly developed at this point, although the RE has indicated to PIR that it has received several inquiries from domestic and international entities seeking to source Paulownia. The RE has stated that these enquiries have generally been for larger amounts than can currently be supplied by the RE (or the industry) at this point, however this does at least indicate some current market demand. While specific domestic and international markets are being considered by the RE, it is assumed that it will initially target the sawn timber market in Australia, involving light structural or decorative applications.

At the present time, there are no existing sale agreements in place for the sale of timber produced from investors' Woodlots under this Project. There is a signed contract with a buyer to purchase some of the processed timber from previous projects (contracted with former RE Primary Securities Ltd), which is valid until 2012. PIR does not, however, have any details on any buyer and cannot confirm their reliability as a future source. This contract does support price levels indicated by the RE for D class logs (according to the Chinese grading system) based on 2004 pricing levels stated by the Unisearch Limited independent marketing report. However, this contract will only cover the assumed first harvest from the 2005/2006 project in year seven (2011) and depends on timber meeting a minimum quality as set out by the grading system being utilised for the contract.

The acquisition of Highpoint by the EFF Group provides another possible distribution point for timber produced by the Project. The RE has informed PIR that it anticipates all timber produced by the Project will either be sold to or via Highpoint, although it reserves the right to sell to other parties. Given that any sales to Highpoint are a potential conflict of interest, the RE has stated to PIR that any transactions will be on an arms length basis or at the price at which Paulownia is trading in international markets.

While the acquisition of Highpoint provides advantages through vertical integration within the EFF Group and as

a potential marketing outlet for investors' timber, it does create the potential for conflicts of interest for any sales being made to Highpoint. Issues relating to the potential for conflicts relate to:

- The relationship between the two parties;
- Disclosure of timber pricing to investors;
- Minimum quality criteria set by Highpoint for the purchase of timber produced by the Project; and
- Payment terms.

The RE has indicated to PIR that in relation to these issues:

- The RE and Highpoint are wholly owned subsidiaries of the EFF Group and that all transactions will be on commercial terms at an arms length basis;
- The RE will detail timber pricing as part of the required annual reporting. Potential conflicts will be managed by pricing using the open market as the basis for negotiations and allowing investors to vote on other proposals should this system prove to be ineffective;
- Given that Highpoint has a brief to develop and explore Paulownia markets, there are no minimum quality specifications at this stage; and
- Payment terms are expected to be normal credit terms of 30 days, in accordance with operations of the EFF Group.

PIR has been informed by the RE that it will endeavour to secure the highest possible price, irrespective of whether this means selling to or via Highpoint.

The RE has undertaken some small scale harvesting in 2005 and 2006 from trees in its original trial plantation at Nowergup, south of the Regan's Ford site where the commercial plantations are located. To date, these harvests have resulted in approximately 100m<sup>3</sup> of rough sawn timber being produced. The RE has not undertaken any sales at this point with this material, but is utilising it for sawing trials and other data collection.

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## Cost Structure & Fees

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The application price of \$6,390 covers the establishment of the Woodlot for the first twelve months. Further annual fees relating to management fees and property rent will need to be met by investors.

Other deferred management costs relating to harvesting, processing and sale of timber produced by the Project will also be payable from any sale proceeds. Compulsory

insurance of investors' Woodlots is to be undertaken by growers. Investors should note that in the event of a claim, as insurance is generally payable on the market value of standing timber, insurance policies are not likely to cover the full amount of a grower's investment until the latter stages of the Project. The RE has taken out public liability insurance with respect to the RE's own operations.

The entire investor's contribution of \$6,390 (\$5,751 net of GST, as GST is refunded if growers are registered for GST) per interest will be applied to the establishment of the Woodlots on land already owned by the RE. The RE must complete all establishment services, including planting of trees, within 12 months of accepting an application from an intending investor.

Based on the size of the Project's Woodlots, the establishment cost of the Project is \$59,167 per hectare. While this is significantly higher than timber projects involved in sectors such as eucalypts, irrigated high value timber plantations tend to require higher establishment and management costs. The total per hectare cost being levied by EFFM is, however, still significantly higher than other Paulownia projects which have been established in recent years.

The funds raised by subscriptions to the Project will be utilised to establish investors' Woodlots on land which has already been acquired by Powton Land Holdings Limited (PLH), which is a wholly owned subsidiary of E.F.F. Limited. Land and infrastructure currently available to the Project at the Regan's Ford site is sufficient to allow for a further 816 Woodlots based on the Woodlot size of 0.108 hectares.

The Responsible Entity is entitled to several fees, which have been included in the financial forecasts. The principal fees are outlined below:

- Application fees for interests in the Project are \$6,390 per Woodlot including GST;
- Management and rental fees of \$710 per Woodlot p.a. during 2008 - 2010, increasing to \$731 per Woodlot in 2011 p.a. for the remainder of the Project;
- Woodlot insurance costs anticipated by the RE to equate to approximately \$14 per Woodlot p.a.

- Marketing fees of 5.5% of the gross sale proceeds;
- The RE will charge investors the cost of harvesting and milling any timber produced by the Project;
- An incentive fee of 27.5% of the net sale proceeds over and above the set thresholds outlined in Table ii; and
- Loan establishment fees (if investor financing is utilised) equating to a flat fee of \$300.

The RE may pay commissions to financial advisers in relation to subscriptions in the Project of up to 10%. Such commissions are drawn from the proceeds of the application fees and are not an additional cost to the investor.

The fee structure charged by the RE provides incentives to maximise investor returns with the implementation of the threshold for the incentive fee. This is intended to provide alignment of investors' interests with the RE, since its deferred fees are performance based. However, the upfront cost of the Project is significantly higher than comparable investments. Based on PIR's financial modelling, the incentive fee thresholds are unlikely to be achieved. While PIR accepts that the RE has been one of the few operators in the MIS industry to produce quality plantation Paulownia to this stage and that quality management generally entails higher levels of inputs, PIR believes that the cost structure is particularly high.

RE Incentive Fee	
Project year	Returns threshold
Year 7	\$4,516
Year 8	\$4,480
Year 9	\$4,654
Year 10	\$27,491

Table ii

#### Project cost structure Per Allotment – Minimum subscription

Application fee per allotment (Including GST)		\$6,390
Establishment cost per hectare		\$59,167
Annual fees (Including GST)	<i>Management &amp; Rent – 2008 - 2010</i>	\$710
	<i>2011 onwards</i>	\$731
	<i>Woodlot insurance*</i>	\$14
Marketing fees†		5.5%
Harvesting & processing costs		As incurred
Incentive fee**		27.5%

\*Anticipated cost, premiums may vary annually

†Calculated as a proportion of gross sale proceeds, plus GST

\*\* See Table ii

Table iii

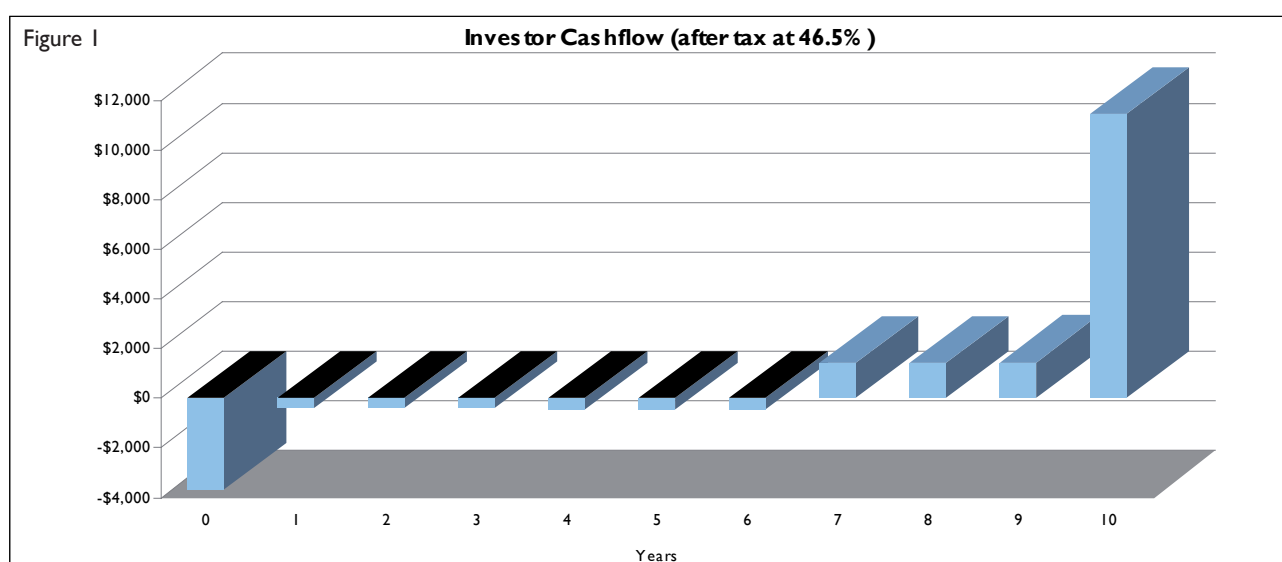
## Income Returns

PIR has examined the financial indicators of the RE and examined the supporting evidence and utilised its own conclusions relating to growth rates, yield and price. PIR has undertaken a 10 year cash flow analysis as part of the financial evaluation process. PIR's financial forecasts incorporate various assumptions in respect of growth rates, yield and timber price as well as other assumptions on related factors. More detail relating to market factors used in PIR's assumptions can be found in the Assumptions section.

PIR's model produces an expected Internal Rate of Return (IRR) of 11.95% after tax for investors with a marginal tax rate of 46.5% and 0% gearing. As shown in Figure 1, the pattern of an investor's cashflow shows that an investment in the Project is not likely to reach a cash flow positive position until year 7. Investors' after tax IRR's are shown in Table v. IRR's do not change across varying tax rates due to the nature of the taxation benefits derived from the Projects.

Project estimated after-tax IRRs	Downside	Expected	Upside
46.5% tax rate	3.00%	11.95%	23.91%
31.5% tax rate	3.00%	11.95%	23.91%
15% tax rate	3.00%	11.95%	23.91%

Table iv



## Assumptions

Risk is measured by variance from the expected case. For the upside and downside scenarios, alternative assumptions have been used in accordance with the standard PIR methodology. Key assumptions included in the RE's financial forecasts, and in PIR's expected case scenario, include:

### Yield

The RE is indicating a total yield of rough sawn timber of 386m<sup>3</sup> per hectare (41.68m<sup>3</sup> per Woodlot) over the term of the Project. Based on the RE's assumptions relating to recovery rates of timber during sawing, this equates to a gross timber yield of approximately 64.1m<sup>3</sup>. While PIR believes that the gross yield is feasible given the current experiences of the Manager and other

information available at this time, PIR has taken a slightly more conservative view on recovery rates. The RE is indicating a recovery rate of 65% during sawing. In small harvest trials to date, sawn timber recovery has averaged approximately 63%.

Other managers of commercial scale Paulownia plantations in Australia, which have undertaken sawing trials of small commercial harvests, have to date reported similar recovery results. While the contractor being utilised by the RE has indicated that future recovery rates may be increased to 70%, PIR has elected to use a recovery rate of 63% in the expected case. This translates into a gross timber yield of 66.16m<sup>3</sup> and a sawn timber yield of 41.7m<sup>3</sup> per Woodlot.

## Prices

The RE has contracted the Parent Entity, E.F.F. Limited, to be responsible for the sale of any timber produced by the Project. At this time, there are no sales contracts between E.F.F. Limited and any other parties for the purchase of timber produced by this Project. PIR has, however, sighted a timber sales agreement confirming that a small amount of timber produced from previous projects has been committed for purchase from Primary Securities Ltd, the previous RE of the Kiri Park Project No. 1 & No. 2. While the agreement is with Primary Securities as RE, since EFFM took over as RE in 2004, it has agreed to assume all contracts and liabilities of Primary Securities. Investors will be reliant on the ability of the RE to sufficiently develop markets over the term of the investment to produce viable product distribution channels for the timber produced by this Project.

In determining a price for the saleable timber from the Project, PIR has used a combination of the 2004 price quoted in the Independent Marketing report of \$943/m<sup>3</sup>, indexed to a 2006 starting value, as well as using sales data from Highpoint, to arrive at a 2006 price of \$975/m<sup>3</sup>.

Forecasting future investment performance is problematic at best and relies on a number of assumptions about future events that may or may not necessarily occur. Changes in even one of the variables affecting investment physical parameters and/or market performance may have a significant and decisive impact on future outcomes. This report provides no more than a general guide to possible future outcomes and must not be relied upon in isolation.

PIR assumptions	Downside	Expected	Upside
Gross Plantation Yield (Cubic Metres / Woodlot Harvest)	54.50m <sup>3</sup>	64.12m <sup>3</sup>	67.33m <sup>3</sup>
Recovery Rate of the Timber	60%	65%	70%
Sale Price of the Timber / m <sup>3</sup> of Rough Sawn Timber	\$902	\$975	\$1,403
Growth in expenses	2.63%	2.50%	2.25%
Growth in sale price	2.00%	2.50%	3.00%

Table v

## Taxation

The Kiri Park Projects 2007 Growers has received Product Rulings PR 2006/150 and PR2006/151 from the Australian Taxation Office confirming the deductibility of fees related to an investment in the Project. There are two product rulings, catering for investment based on ungeared and geared investments. Investors are advised to read the product ruling(s) in order to determine how they apply to their individual circumstances.

The taxation implications of investing in the Project may vary according to the investment structure adopted by investors and potential changes to the Taxation Act. There

is some current speculation that some changes to the provisions of the Act governing tax deductibility may be detrimental to the MIS industry, however no details are currently available and therefore no consideration has been given to the potential consequences of any changes in this evaluation.

**It is strongly recommended that investor's seek/obtain professional and independent financial and taxation advice before choosing to purchase units in this or any investment vehicle.**

## Risk

Risks faced in projects relating to agribusiness investments generally include those specifically related to the commodity being produced, management risk and market risk. Investors' interests in the Project may be subject to the following risks:

### Industry Risk

#### Markets

Commercial Paulownia plantations in Australia have not yet reached the stage of being harvested on a large scale, therefore sawlog yields and markets are as yet largely

untested. While the market for plantation grown timbers may, in theory, increase as pressure on native forests rises along with consumption of timber products, the market for Paulownia is as yet unproven on a large scale. Market penetration and competition from both existing and possible future substitute products needs to be considered. Given the increasing sentiment for plantation grown timber versus native forests it is reasonable to assume that markets will become available for Paulownia timber, providing the characteristics of the timber remain suitable for its target markets.

*This report does not form any part of any offer document*



## Production Risk

### **Environmental Risk**

Timber plantations, like most agricultural operations, are subject to risks from pests and diseases devaluing or destroying a crop. PIR is not aware of any major diseases that affect Paulownia in Australia at this time, but plantations in China and the US are subject to such threats. Sound management practices and integrated pest management control will help to mitigate these risks. The RE's policy of replacing any trees in investors' Woodlots which perish within the first 12 months from planting minimises risks, as most species are more susceptible to damage and mortality at a young age.

The risk of natural disasters such as fire, wind damage, hail and other events outside the general control of the RE need to be taken into account. Individual investors are obliged to undertake compulsory Woodlot insurance against such risks as part of the Project. The RE does not insure investors Woodlots, although it does carry public liability insurance. Investors should note that in the event of a claim, insurance is generally payable on the market value of standing timber, and as such, insurance policies may not cover the full amount of a grower's investment until the latter stages of the Project.

### Agronomic Risk

Previous history of production can be a good indicator of the agronomic ability of a site to produce a quality product. To date, while growth can be measured during a forestry rotation, the Kiri Park plantation has not yet hosted a full rotation of Paulownia and as such no reliable conclusions on achievable harvest yields can be drawn.

Soil types have been investigated at the site and PIR has examined the available soil reports, and has also been advised by the RE that plantings have been determined in line with the recommendations of these survey results.

Water availability, quality and quantity is also reported as being sufficient to the Project at maximum size and further refinements to the irrigation system are being made in order to maximise efficiency.

Agronomic risk also relates to the ability to perform all plantation development and maintenance tasks in a timely and competent fashion. With increases in the plantation area under management, and the relative remote location

of the Kiri Park site, management will need to adequately resource the Project, both from a machinery, resource and personnel perspective.

The main agronomic risks facing Paulownia involve waterlogging. The Regan's Ford site is not subject to natural waterlogging and its positioning in a soil profile of predominantly deep sands helps to mitigate this risk, as does appropriate irrigation scheduling.

### Management Risk

Business risk relating to management decisions and/or management failure is a key element of any business venture. Management risk can be mitigated through insurance (liability and keyman insurance), succession planning, a strong compliance regime and clear due diligence methods. PIR has conducted a compliance review of the RE, ascertained its level of public liability insurance and interviewed key management personnel.

Other management risk involved with primary production projects relates to the public perception of the Managed Investment Scheme industry. Companies in a growth phase that derive a large proportion of business revenue from subscriptions are at risk from an industry downturn. Companies which are more entrenched and can continue operations from ongoing management fees, or the receipt of ongoing deferred fees are much less susceptible to these risks.

### Other Risks

#### **Taxation**

The Project currently has two rulings from the ATO relating to the tax deductibility of investment into the Project. If the terms of the rulings are not adhered to, the ruling and consequent deductions may be revoked. This may occur if the ATO deems that the Project has not been implemented according to the terms of the ruling, if it is materially different to the arrangement ruled upon, or in the event of grower default.

#### **Currency risk**

Exchange rate movements may indirectly impact prices received for Australian grown Paulownia as exchange rates between Yen, USD and AUD, and any other relevant currencies, fluctuate. This risk may be mitigated by contractual arrangements and hedging of currency.

## Liquidity and Exit Mechanism

The Project is anticipated to have an investment term of 10 years, at which time investors' Woodlots are assumed to be clearfelled and the produce sold. An investment in the Project should be considered long term and illiquid. As there is currently no formal secondary market for interests

in the Project, investors must assume that this is a long term investment with redemptions possible no earlier than 2016. The RE has no obligation to purchase or redeem the value of an investor's interests.

## Capacity of Manager

The Kiri Park Projects 2007 Growers is managed by Environmental Forest Farms Management Limited, a Western Australian funds manager which is a wholly owned subsidiary of Environmental Forest Farms, established in 1997. E.F.F. Limited has been involved in the establishment of four previous Agribusiness Managed Investment Schemes involving the cultivation and management of Paulownia plantations in WA. EFFM was issued with an Australian Financial Services Licence in 2004 and was voted in as RE to the three existing projects in May 2004, with Primary Securities agreeing to resign as RE and support EFFM and the new Manager. Since inception, E.F.F. Limited has established over 170,000 Paulownia trees and raised over \$10.9 million in investor subscriptions.

The RE is an unlisted public company, with financial accounts as at 30 June 2005 showing Total Equity of \$2,782,157 and Total Assets of \$4,489,546.

Financial Position Year ended 30 June			
	2004	2005	2006
Total assets (\$000)	\$3,738	\$4,490	\$4,804
Total Liabilities (\$000)	\$2,816	\$1,707	\$2,654
Net Assets (\$000)	\$923	\$2,782	\$2,149
Debt to Equity	3.0	0.6	1.2
Current Ratio	1.0	1.3	1.2

Table vi

The financial strength of EFFM has been improved as the company has paid off bank loans undertaken in 2004. EFFM derives its income from two principal sources – new project income and ongoing or “annuity style” income. New project income comprises rent/licence fees and management fees payable on subscription in the first year of a project. The ability of the company to continue to generate new project income will therefore depend on its ability to continue to offer projects. PIR notes that E.F.F. Limited has been involved in the successful offering of moderate sized capital raisings in agribusiness projects since 1999. Given the fact that the Regan's Ford site has a limited number of available Woodlots remaining and that

the RE appears to rely heavily on subscription income to generate profits, the RE's continued financial security may be vulnerable until additional land can be sourced for new projects or additional income from harvest and incentive fees become available from existing projects.

The RE has indicated to PIR that it believes that the management fees from existing projects provide it with a sufficient cashflow to maintain business operations if Woodlot sales cease.

PIR conducted a compliance review of the RE on 4 April 2006. The EFF Group was founded in 1997 with the initial plantation undertaken in 1999. Subsequent schemes were operated under Primary Securities Limited ('PSL') as the responsible entity of the schemes. In 2003, the E.F.F. Limited Board became divided over the business, primarily because of a crisis caused by lack of cash flow. AustAsia Group ('AAG'), of which Mr Sydney Chesson is a principle, acquired 48% of Environmental Forest Farms Limited, the parent of EFFM, in 2003. AAG has effective control of both E.F.F. Limited and EFFM. EFFM was established in 2004 and PSL was asked to resign as the RE of the existing schemes.

E.F.F. Limited has recently further consolidated the ownership structure of the Group, by completing a takeover of Powton Land Holdings ('PLH'). Powton Land Holdings is the Group land company, which has financed its operations by issuing 10 year debentures. E.F.F. Limited now owns 100% of PLH. AAG's interest in E.F.F. Limited will decrease from 48% to between 35 to 40%. It will, however, retain effective control of this business.

The Directors and key personnel of the RE are as follows:

### **Sydney Chesson, MBA, CREM, CSM, FAICD**

**(Chairman):** Mr Chesson has over 27 years experience in real estate and other business and commercial activities. He has been a Director of several listed and unlisted public companies as well as private companies and is also the Chairman of E.F.F. Limited Ltd, Forestry Finance Limited and Beenyup Farms Pty Ltd.

**Geoffrey Coad, LLB, GAICD (Non-Executive Director):** Mr Coad has an extensive background in Law with over 30 years experience in the legal sector. Mr Coad is also a Director of E.F.F. Limited Ltd, Forestry Finance Limited and Beenyup Farms Pty Ltd as well as being an external compliance committee member for several managed investment schemes.

**Victor Turco, B.Bus, CPA (Non-Executive Director):** Mr Turco has a background in accountancy with over 25 years experience within Australia and overseas. Mr Turco is also a Director of E.F.F. Limited Ltd, Forestry Finance Limited and Beenyup Farms Pty Ltd as well as being an external compliance committee member for several managed investment schemes.

**Simon Chesson, MBA, CPA, CFP, B.Comm (Company Secretary and Responsible Officer):** Mr Chesson has experience in the MIS industry and has been involved in establishing and running several MIS projects in the agribusiness and property sectors. Mr Chesson is also the Company Secretary for all the companies in the EFF Group.

**Bruce Jamieson (Operations Manager and Responsible Officer):** Mr Jamieson is the plantation manager of the Group's plantations at Nowergup and Beenyup and has had a long involvement with the establishment and management of Paulownia plantations.

**Wade Baggott, BSc, MBA (Forestry Administration Manager):** Mr Baggott has a degree in Environmental Science majoring in Forestry and a Master of Business Administration Environmental Management where his Master's Research Thesis was on the growth and development of Paulownia. Mr Baggott is responsible for analysis of the Group's research data as well as reporting to the Company Secretary on issues relating to due diligence, investor relations and activities relating to plantation activities.

Laurie & Beverley Jolly act as the plantation managers of Kiri Park and have both been involved with the development of the plantations for six years. Mr Jolly has a background in Forestry with experience in managing forestry plantations in South Australia and Western Australia.

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## Industry Overview

Paulownia timber (Paulownia spp) is a hardwood timber that originates in China and is grown over much of coastal Australia, although is concentrated in Queensland and Western Australia. Several species have been planted in Australia to date, most notably P.fortunei, P.tomentose and P.elongata, however P.fortunei is currently considered to have the highest commercial potential and is the species currently being utilised by another MIS RE for its projects.

Paulownia is best suited to areas with high rainfall and deep soils, although irrigation is often used to supplement rainfall. Paulownia is regarded as a lightweight utility timber that is not suitable for certain structural applications, but is being targeted for applications in the marine industry, decorative building, veneers and for light furniture. The desirable characteristics of Paulownia timber include:

- High growth rates making it competitive as a short rotation forestry crop;
- lightweight with a high strength to weight ratio;
- highly stable as a sawn timber with resistance to warping or splitting with minimal shrinkage characteristics;
- staining ability to be easily coloured as a finished product (although with some incidences of uneven finishing);

- high insulating properties, having one of the lowest thermal conductivity levels of all timber species;
- ability to be air dried over a comparatively short period, which reduces costs of processing as kiln drying is not required; and
- high level of machinability, giving Paulownia a competitive advantage over many other species and a point of attraction to end user markets.

Despite a long tradition of use in China, Paulownia does not have a long commercial history in Australia, with few medium to large scale commercial plantations having reached harvesting maturity as yet. As such, a market outlook for Australian produced Paulownia timber is not clear. Currently, the industry is generally comprised of small scale growers, with any resulting timber likely to vary widely in quality.

Paulownia is generally targeting the markets currently being filled by species such as Western Red Cedar, Meranti, Hoop Pine and a range of tropical varieties grown in Thailand, Vietnam and other Asian regions. While the push for plantation grown timber in Australia as a result of the Federal Government's Plantations 2020 vision statement provides scope for increasing reliance on plantation timbers, Paulownia is a product which is currently in a relatively early development stage of its product lifecycle, with substitute products being produced domestically and overseas.

*This report does not form any part of any offer document*

Paulownia exists in a market with comparatively few barriers to entry from overseas products produced at a cheaper price. Further development of markets for Paulownia timber relating to product substitution and market acceptance of the product will have a significant bearing on the profitability of Paulownia plantations in Australia which are reaching maturity, as well as plantations planted in the future. Demand for decorative lightweight timber is currently rising domestically and overseas (particularly Asia) as the supply of Meranti, Western Red Cedar and other timbers from native forests declines.

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## **Agronomic analysis**

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PIR has conducted site inspections of the Regan's Ford site on 23 March and 7 November 2006, as well the RE's trial sites at Nowergup on 23 March 2006.

### Location

The Kiri Park property is located south of the township of Regan's Ford, in the Shire of Gin Gin, approximately 130 kilometres north of Perth. The property is approximately 536 hectares, of which approximately 300 hectares is currently under Paulownia, with an additional 115 hectares proposed under this Project. Full subscription under this Project will effectively fill the remaining area of the property considered suitable by the RE for planting Paulownia at Kiri Park.

The properties adjoining Kiri Park at Regan's Ford and surrounding Kiri Park in the Gin Gin Shire and adjoining Dandaragan Shire are used predominantly for broad acre farming and some stock grazing. Over the past five years there has been an increasing growth of irrigation in the area, which may have some impact on long term irrigation constraints and regulations. There are also several smaller scale Paulownia plantations in the region, which PIR understands are generally less developed than that at Kiri Park.

### Climate

*P. fortunei* is a deciduous tree species, with a natural occurrence between latitudes 20 degrees and 30 degrees in the warm temperate to tropical zones. Basic climatic conditions in its natural habitat consist of temperature ranges from 0°C to 40°C with an annual rainfall of 500 to 1200 mm prevailing in spring and summer.

Climate data was reviewed from the Bureau of Meteorology site at Moora. The area could be described as a warm to hot Mediterranean climate throughout the growing season, with cool winters. Rainfall is relatively low (460 mm per annum), and winter dominant.

While Paulownia is currently being undercut on price by some existing products harvested from native forests, diminishing natural reserves are expected to drive prices up for rough sawn timber in the medium to long term. Combined with the acceptability of plantation produced timber versus timber produced from native forests, plus the cost efficiencies and relative uniformity of plantation produced timber, Paulownia is well placed to enter the market, assuming quality standards meet market demands over the long term.

Maximum rainfall occurs in the months May to August, with greater than 50 mm each month.

Summer can be very hot, with extreme temperatures above 45°C previously recorded. Damage to young trees in particular will occur under these extreme events, but most high temperatures can be managed with irrigation scheduling.

### Water Supply

Adequate water supply is critical to a project of this size in a dry climate such as the Gin Gin area. Paulownia as a species is not tolerant of either drought or waterlogging conditions.

Discussions with the Manager on site indicated that water was available from the underground aquifers of the property. The RE has a Licence to access 1.7 gigalitres of ground water annually, for the irrigation of 360 hectares of trees. This licence is deemed to be sufficient for irrigating all the plantings, current and proposed under existing irrigation regimes. The RE has recently upgraded the irrigation systems at the property to enable greater management control of block watering and fertigation to the plantation. The RE has implemented the use of remote sensors and tensiometers to increase efficiency and aid irrigation scheduling.

A relatively small amount of water storage is available on site to allow for back up supply to the plantation. This storage is in a dam, which has been constructed within the last 12 months, with a capacity sufficient for three days of normal irrigation requirements at current plantings and growth levels.

Irrigation water supplies at the Regan's Ford site come from ground water, which, unlike irrigation supplies from rivers, does not have the same levels of restriction in licensing and costs. Water quality is high, with samples showing very low salt levels. PIR is satisfied that there



is likely to be sufficient water available through natural rainfall and irrigation licenses to sustain the Project through normal climatic conditions at full investor subscription. Investors should, however, be aware of the potential for prolonged drought conditions to impact on any agricultural venture in Australia and the possibility of future restriction in irrigation licensing, which may impact on the ability of the RE to maintain crucial water supplies to the Project.

### Soils

Soil surveys have been previously conducted at Kiri Park when the plantations were first established, although these have not been made available to PIR. During the course of the site inspection, PIR noted that the soils have been historically very poor in organic matter, but the Manager is continuing a program of incorporating organic matter to improve organic matter levels to aid water holding capacity and nutrient management.

### Other Issues

Like most crops, pressure from competing species needs to be minimised. Since irrigation also promotes the growth of weed species, intensive management is required to minimise competition issues. The RE utilises a regime of slashing and spraying to control weeds in the Kiri Park plantations, as well as some plastic mulching over the treelines. PIR's site inspection revealed weed control being pursued at a high level at the time of the visit.

Young trees are susceptible to damage from extraneous sources, such as attack from insects or fungal diseases. Discussions with the Plantation Manager indicate that an ongoing system of monitoring and preventative measures in the plantations are minimising damage to trees. The RE has an agreement to replace any trees which perish within the first 12 months of the Project at its own cost. Trees older than 12 months face less risk of permanent damage

from insect or disease damage. Hail damage is another damage risk to young Paulownia trees, but is not prevalent in this region.

### Planting Material

Planting material for the Project is sourced from parent stocks grown by E.F.F. Limited in its trial plantations at Nowergup. There is expected to be a continuing advantage in the RE working to refine its own stock of genetic material, which has been grown in a location close to the Kiri Park site under very similar agronomic and climatic conditions. E.F.F. Limited has licensed clonal material EFF1 under the Plant Breeders Rights Act, which represents intrinsic intellectual property value to the Company.

### Production Forecasts

PIR considers the total yield forecasts of 386m<sup>3</sup> per hectare used in the financial modelling to be a realistic forecast, given the industry information available at this time, but highly dependant on the recovery rate of the sawn timber. While recovery rates themselves may rise, not all timber recovered will be able to achieve the same grade and price.

### Independent Experts Report

The expert report prepared by Mr Charles Peaty has been reviewed as part of this report. The report is of a general nature relating to Paulownia site requirements, such as water, soils and climate, as well as silvicultural issues and potential harvest yields.

The report discusses an expected timber yield of 386m<sup>3</sup> per hectare, which PIR believes to be achievable.

In general, the comments of the expert report follow sound forestry principles relating to the propagation and management of Paulownia. The report also discusses the risks associated with Paulownia production, and these are in line with the assessments made by PIR.



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## Due Diligence

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PIR was engaged by **Environmental Forest Farms Management Limited** to undertake this investment evaluation for a fixed fee established prior to commencement of work on the investment evaluation. Property Investment Research Pty Ltd (PIR) advises that in the compilation of this report, PIR has not conducted a full due diligence on this offer. Investors would be well advised to consult the offer document dated 6 November 2006, conduct their own inquiries, and receive professional advice. This report was not prepared to form any part of any offer document.

PIR has relied upon information contained in the offer document dated 6 November 2006. PIR has carried out its own independent inquiries by:

- inspecting the site; and
- and meeting representatives of the Responsible Entity.

PIR has also conducted a separate compliance review of the RE on 4 April 2006. PIR has received copies of the PDS, Trust Constitution and Compliance Plan, which have been registered by the Australian Securities and Investment Commission (ASIC) and accounting report including the tax schedule.

PIR has also received copies of the following documents:

- PDS dated 6 November 2006;
- Manager's Project model and financial forecasts;
- CV's for key personnel;
- ATO Product Rulings PR2005/150 and PR2006/151;
- Australian Financial Services License for EFFM No. 239 635;
- Lease and Management agreement (undated);
- Forestry Finance Limited finance packages for the Kiri Park Projects 2007 Growers;
- Timber marketing agreement between EFFM and E.F.F. Limited (undated);
- Timber sale agreement between EFFM, Primary Securities and Mydale Pty Ltd dated 8 February 2001;
- Certificate of Currency for PI Insurance;
- Head lease between Powton Land Holdings Limited and EFFM;
- Water license from Water & Rivers Commission for the Kiri Park property; and
- EFFM annual financial reports for FY 2004, 2005 and 2006.

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## Explanation of Investment Rating

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The Investment Rating Financial Model (patent pending) provides a single measure of the overall investment merit of this vehicle for various investor profiles. It incorporates the level of expected returns (IRRs) from the investment and adjusts these for both illiquidity and risk associated with this investment, presenting them across the three main marginal tax rates. The Investment Rating is based on the premium of the estimated risk-free, after-tax IRR adjusted for illiquidity over the prevailing 10-year bond rate. This measure enables the valid comparison of an investment with any other for nine (tax rate and risk tolerance) investor profiles. This facilitates the task of tailoring investment selection to the needs of the individual investor. Further, it provides ratings in which the advisers and investors can have unprecedented confidence. The ratings presented in the risk tolerance/tax rate matrix are only a representative sample of those available on PIR's unique individually tailored on-line investment selection system.

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For ease of comprehension, the Investment Rating uses symbols similar to those applied by credit rating agencies. These ratings should not, however, be confused or compared with those used by credit rating agencies. The seven published Investment Ratings from lowest to highest are: A- A A+ AA- AA AA+ AAA. Projects with ratings below A- are not considered investment grade.

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Richard Cruickshank, Managing Director.

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